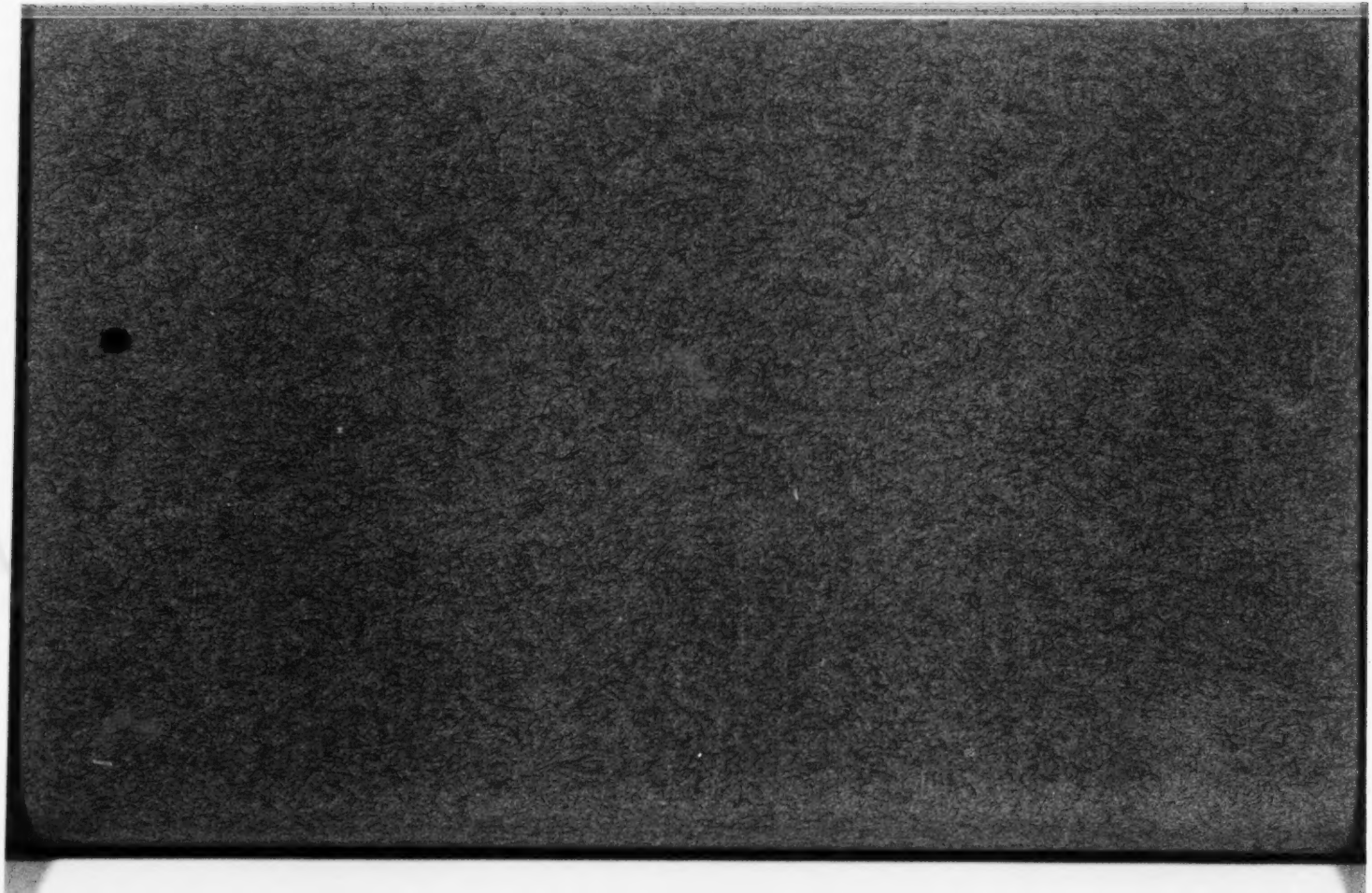

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In the Supreme Court of the United States

OCTOBER TERM, 1944

No. 646

FLORA REGENSBURG, AS EXECUTRIX OF THE ESTATE OF JEROME REGENSBURG, DECEASED, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

No. 647

MELVILLE E. REGENSBURG, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

No. 648

MORTIMER REGENSBURG, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

No. 649

ISAAC REGENSBURG, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

No. 650

MELVILLE E. REGENSBURG AND SOPHY P. REGENSBURG, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The memorandum opinion of the Tax Court (R. 85–93) is not reported. The opinion of the Circuit Court of Appeals (R. 252–258) is reported in 144 F. 2d 41.

JURISDICTION

The judgments of the Circuit Court of Appeals were entered on August 8, 1944 (R. 267–271). A petition for rehearing was denied on August 8, 1944 (R. 266). The petition for writs of certiorari was filed on November 1, 1944. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the court below erred in sustaining the Tax Court's finding that withdrawals of ac-

cumulated earnings of a family corporation by its principal stockholders, made in the form of open account loans, were in fact dividend distributions as defined in Section 115 of the applicable Revenue Acts.

STATUTES AND REGULATIONS INVOLVED

The pertinent statutory and regulatory provisions appear in the Appendix, *infra*, pp. 16–18.

STATEMENT

E. Regensburg & Sons is a New York corporation, organized in 1903 to manufacture and deal in tobacco products. It was the successor of a partnership conducted by Edward Regensburg and his five sons; all of the corporation's securities, consisting of 1,000 shares of $100 par value stock and $223,150.36 interest-bearing notes, were issued to them. The father died in 1910. The petitioners include three of the sons, Melville, Mortimer and Isaac, and the estate of Jerome, another son. The remaining petitioner, Sophy Regensburg, is the wife of Melville, with whom she filed a joint return for 1940. (R. 85–86.) The five companion cases involve identical issues. They were consolidated for hearing both before the Tax Court (R. 6) and the Circuit Court of Appeals (R. 250).

Since the father's death, his five sons have been the principal shareholders and the officers and directors. From September 1931 to Novem-

ber 1941, they owned together all but 75 shares which were held by relatives, and after November 1941, they owned all but 35 shares. From 1936 to 1939, Mortimer and Isaac each owned 264 shares, Jerome owned 174 shares, and Melville and the fifth brother, Bellette, who is not a petitioner, each owned 114 shares. In December 1939, Mortimer bought 17½ shares, and in October 1940, the other four brothers bought another 17½ shares from the relatives; each block of 17½ shares had a book value of about $74,000 and was purchased for $60,000. (R. 86, 88.) The four petitioning brothers are ordinarily hereinafter referred to as the taxpayers.

From the organization of the corporation in 1903, taxpapers maintained with the corporation individual open accounts in which withdrawals were debited and in which salaries, dividends declared, and interest due on the corporation's notes held by taxpayers were credited (R. 87). The withdrawals were made by taxpayers at pleasure and without previous consultation among them (R. 89, 91). The amounts withdrawn or otherwise debited to each taxpayer were greater than the amounts credited to him so that, except in a few early years, the debit balances kept increasing (R. 88). The total withdrawals and credits of taxpayers from 1903 to the end of 1940, and their net debit balances as of the end of 1940, were as follows (R. 90):

	Cash withdrawn or paid on his behalf by corporation 1903–1940	Salary	Credits Dividends	Miscellaneous	Total net debit balance Dec. 31, 1940
Mortimer	$2,560,845.08	$1,140,900.03	$555,000.00	$115,556.87	$749,388.11
Isaac	3,511,566.80	1,140,900.04	555,000.00	137,994.95	1,677,671.81
Jerome	1,535,028.03	861,595.99	394,800.00	73,578.83	250,053.21
Melville	1,401,400.85	752,645.84	211,650.00	38,185.40	398,919.61

The company's by-laws provided that "The Board of Directors shall, by vote, declare dividends from the surplus profits of the Company whenever in their opinion the condition of the company's affairs will render it expedient for such dividends to be declared by them" (R. 86).

Throughout the corporation's history, dividends were declared and salaries fixed at meetings of the board of directors formally called for the purpose. From 1904 to and including the year 1935 (the year prior to the taxable years here involved), dividends totaling $2,270,000 were declared. With the exception of 1930, substantial dividends were declared in each year from 1923 to 1935; and in each of the years 1933, 1934 and 1935 dividends in the amount of $200,000 were declared. (R. 86–87.)

From 1936 to 1940, the taxable years here involved, no dividends were declared and the corporation reported none in its income tax returns (R. 87). Taxpayers continued, however, to make withdrawals during those years in excess of amounts credited to their accounts, and their net

debit balances increased. Mortimer's net debit balance at the end of 1935 was $580,647.88 and had grown to $749,388.11 by the end of 1940; Isaac's net debit balance at the end of 1935 was $1,407,-196.16 and had grown to $1,677,671.81 by the end of 1940; Jerome's net debit balance at the end of 1935 was $167,171.30 and had grown to $250,-053.21 by the end of 1940; and Melville's net debit balance at the end of 1935 was $327,440.61 and had grown to $398,919.61 by the end of 1940. (R. 88.)

The shareholdings and the net withdrawals by taxpayers during the taxable years were as follows (R. 88):

		1936	1937	1938	1939
Mortimer	264 Shares	$81,552.62	$50,216.13	$33,644.16	
Isaac	264 Shares	143,208.96	63,387.32	37,560.55	$5,405.25
Jerome	174 Shares	40,426.30	31,308.83	17,762.11	
Melville	114 Shares	32,663.16	30,002.31	14,526.08	

		1940	Total 1936–1940
Mortimer	281½ Shares	$5,774.59	$171,157.50
Isaac	268¾ Shares	20,913.57	270,475.65
Jerome	178¾ Shares	3,002.28	92,499.52
Melville and Sophy	118¾ Shares	3,061.30	80,252.85

The corporation had no current earnings during the taxable years but had an earned surplus during those years as follows (R. 86):

January 1, 1936	$4,855,067.25
December 31, 1936	4,781,207.08
December 31, 1937	4,599,165.83
December 31, 1938	4,425,437.34
December 31, 1939	4,266,930.67
December 31, 1940	4,183,133.15

The net withdrawals by taxpayers during the taxable years were distributions of earnings accumulated after February 28, 1913 (R. 88). No interest was accrued or paid on the withdrawals and no note or other evidence of indebtedness was given for the debit balances. Shareholders who were not officers or directors at no time made withdrawals or received any funds from the corporation except to the extent that dividends were formally declared. The withdrawals from the corporation constituted practically all of taxpayers' income, and taxpayers owned no other income-producing property. (R. 89.)

The corporation at all times kept complete account of withdrawals made by petitioners and all credits, carrying the excess of withdrawals over credits as accounts receivable. It treated such accounts receivable as assets and included them on its income tax returns, its balance sheets, and in financial statements to credit agencies and to banks which honored its trade acceptances and extended credit to it. It at no time cancelled, compromised or forgave taxpayers' debit balances. (R. 89.)

After 1910, the credits in each account consisted almost entirely of the fixed salaries and dividends (R. 88). In addition to these credits, the accounts of taxpayers show certain miscellaneous credits. In 1915, taxpayers' salaries were increased retro-

actively for the period 1910–1915 and the increase was ordered applied to their overdrafts up to December 31, 1915 (R. 87). In 1912, Isaac was credited with a cash contribution of $10,000, and in 1924 with a contribution of $15,000, neither of which was sufficient to cause a reduction in his net debit balances for those years. In 1939, the account of each taxpayer was credited with $14,912.66, his distributive share of their mother's credit balance on the corporation's books at the time of her death (R. 89). With the exception of these credits, taxpayers have made no repayments of their withdrawals (R. 92).

On October 8, 1934, all the shareholders made a formal agreement that if any of them should sell any of their shares while indebted to the corporation, so much of the purchase price as would be necessary to discharge such debt, without interest, would be paid to the corporation or, if the corporation were the purchaser, it would make such deduction from the purchase price. The shareholder would continue liable for any unpaid balance. The corporation was given a lien on the shares and the fact of the agreement was to be endorsed thereon. The stock so endorsed was delivered to the corporation. None of the taxpayers ever sold any shares of the corporation. (R. 89–90.)

At a meeting of the board of directors on May 31, 1938, salaries were reduced 25% and a resolution was adopted that "effective at once no withdrawals of cash for the purpose of loans to officers

be permitted" (R. 90). Withdrawals, however, continued as before, and the net debit balances were even larger in 1940 than they were in 1938 (R. 88).

On May 4, 1942, after the deficiency notices in these proceedings were sent, the corporation filed a claim against Jerome's estate for $251,277, representing "loans and advances" secured by collateral lien on his shares in the corporation. No objection was made to the claim by the widow-executrix and it has been recognized as a duly proven and binding claim. (R. 90, 93.)

In their income tax returns for 1936 to 1940, inclusive, taxpayers did not report any of their withdrawals from the earned surplus as income. The Commissioner determined that the net withdrawals were dividend distributions and computed deficiencies accordingly. (R. 24–31, 37–42, 48–55, 60–68, 73–76.) The Tax Court sustained the Commissioner's determination (R. 94–98) and the Circuit Court of Appeals affirmed (R. 267–271).

ARGUMENT

The decision below is controlled by established principles governing the scope of review of Tax Court decisions, and taxpayers do not, and cannot, assert that this case presents an important question.

1. Whether a withdrawal of corporate earnings by stockholders constitutes a dividend or a loan does not, as taxpayers assert (Pet. 9, 12), present a question of law. It is settled that this

narrow issue is one of fact, and turns upon whether it was intended that the withdrawal be repaid. If the withdrawal is intended as a permanent distribution, it is a dividend as defined in Section 115 of the applicable Revenue Acts (Appendix, *infra*, pp. 16–17) notwithstanding that the formalities of a dividend declaration have not been observed, that the withdrawal is recorded on the corporate books as a loan, that it is not in proportion to stockholdings, or even that some of the stockholders do not participate in it. *Chattanooga Sav. Bank* v. *Brewer*, 17 F. 2d 79 (C. C. A. 6th), certiorari denied, 274 U. S. 751; *Christopher* v. *Burnet*, 55 F. 2d 527 (App. D. C.); *Hadley* v. *Commissioner*, 36 F. 2d 543 (App. D. C.); *Anketell Lumber & Coal Co.* v. *United States*, 1 F. Supp. 724 (C. Cls.); *P. Garvan, Inc.* v. *Eaton*, 20 F. 2d 422 (D. Conn.); *Meyer* v. *Commissioner*, 45 B. T. A. 228; *Kinnear* v. *Commissioner*, 36 B. T. A. 153, dismissed, 95 F. 2d 997 (C. C. A. 9th); *Murchison* v. *Commissioner*, 32 B. T. A. 32; *Marshall* v. *Commissioner*, 32 B. T. A. 956; cf. *Lincoln Nat. Bank* v. *Burnet*, 63 F. 2d 131 (App. D. C.); *Faris* v. *Helvering*, 71 F. 2d 610 (C. C. A. 9th), certiorari denied, 293 U. S. 584; *Phelps* v. *Commissioner*, 54 F. 2d 289 (C. C. A. 7th), certiorari denied, 285 U. S. 558; *Clark* v. *Commissioner*, 84 F. 2d 725 (C. C. A. 3d); see 1 Mertens, Law of Federal Income Taxation, Sec. 9.25. On the other hand, where it is intended that the with-

drawal be repaid, it is a loan and becomes a taxable dividend only if the corporation should later cancel the debt. *Wiese* v. *Commissioner,* 93 F. 2d 921 (C. C. A. 8th), certiorari denied, 304 U. S. 562; *Cohen* v. *Commissioner,* 77 F. 2d 184 (C. C. A. 6th), certiorari denied, 296 U. S. 610; *Commissioner* v. *Cohen,* 121 F. 2d 348 (C. C. A. 5th); *Allen* v. *Commissioner,* 117 F. 2d 364 (C. C. A. 1st); cf. *Waggaman* v. *Helvering,* 78 F. 2d 721 (App. D. C.), certiorari denied, 296 U. S. 618; *Fitch* v. *Helvering,* 70 F. 2d 583 (C. C. A. 8th).

Taxpayers rely (Pet. 5) on the provision in Article 115–1 of Treasury Regulations 94 (Appendix, *infra,* pp. 17–18) that a taxable distribution "shall be included in the gross income of the distributees when the cash or other property is unqualifiedly made subject to their demands", but this provision has no bearing on the issue presented. It relates solely to the reporting period, and requires taxable dividends to be reported in the year constructively received, though not actually then received. The question here is not when the corporate earnings were received by taxpayers, for they admittedly were withdrawn and therefore unqualifiedly received during the taxable years, but whether they were received as dividends or loans. The intention of the parties, a matter traditionally within the field of fact finding, is determinative of the latter question.

2. The decision below is not, as taxpayers al-

lege (Pet. 6–7), in conflict with *Cohen* v. *Commissioner,* 77 F. 2d 184 (C. C. A. 6th), certiorari denied, 296 U. S. 610; *Wiese* v. *Commissioner,* 93 F. 2d 921 (C. C. A. 8th), certiorari denied, 304 U. S. 562; *Commissioner* v. *Cohen,* 121 F. 2d 348 (C. C. A. 5th); or *Allen* v. *Commissioner,* 117 F. 2d 364 (C. C. A. 1st). In those cases, it was held that withdrawals of corporate earnings which were originally loans became taxable dividends when the loans were later cancelled. It is significant that in each of them the Board (now the Tax Court) had found that the withdrawals were in fact loans in the first instance; and in each of them the Circuit Court of Appeals held that since the Tax Court's decision was supported by substantial evidence it would not be disturbed. In the instant case, the Tax Court found on the basis of all the evidence that taxpayers did not intend to repay their withdrawals and that consequently they were dividend distributions. This finding, since it is supported by substantial evidence, is likewise conclusive on review.

3. Taxpayers contend (Pet. 5, 9–13) that there is no evidence to support the Tax Court's inference that the withdrawals were here intended as permanent distributions. This contention is, of course, incompatible with their simultaneous insistence (Pet. 9, 12) that whether the withdrawals were intended to be dividends or loans presents a legal question. Moreover, the argument rests upon only

a portion of the record and ignores the evidentiary basis upon which the Tax Court reached its conclusion, and upon which the court below relied (R. 256–257) in sustaining it. The record discloses that taxpayers, who owned practically all the stock and were the directors and officers of the corporation, for over forty years had consistently engaged in the practice of withdrawing the corporate profits at pleasure, irrespective of the amounts of dividends declared or salaries credited to their accounts; that the excess of withdrawals over credits steadily increased each year, including the taxable years; that no note or other evidence of indebtedness was ever given for the excess of withdrawals over credits; that the debit balances had no maturity date but ran on indefinitely; that no interest was charged; that with the exception of two relatively minor payments by one of the taxpayers in 1912 and 1924, neither of which was sufficient to cause a reduction in his net debit balance for those years, no cash repayments were made; that no attempt was ever made by the corporation to collect the debit balances but that on the contrary they mounted each year; and that taxpayers had no outside means of repayment (R. 85–92, 150–151, 175–176, 183–190). Certainly these uncontroverted facts afforded a substantial basis for the Tax Court's inference that the excess of withdrawals over credits in the taxable years represented per-

manent distributions of the corporate earned surplus rather than temporary loans.

4. There is no merit in taxpayers' statement (Pet. 7, 9–13) that the court below misapplied the principles governing the scope of review of Tax Court decisions. The argument assumes that the court below was required to substitute its own inference for that of the Tax Court by attaching conclusive weight to those facts which pointed to a loan. But it is axiomatic that "It is the function of the Board, not the Circuit Court of Appeals, to weigh the evidence, to draw inferences from the facts, and to choose between conflicting inferences". *Wilmington Co.* v. *Helvering,* 316 U. S. 164, 168; see also *Dobson* v. *Commissioner,* 320 U. S. 489, rehearing denied, 321 U. S. 231; *Helvering* v. *Kehoe,* 309 U. S. 277, 279; *Helvering* v. *Nat. Grocery Co.,* 304 U. S. 282, rehearing denied, 305 U. S. 669. Taxpayers' reliance (Pet. 7, 9) upon *Commissioner* v. *Heininger,* 320 U. S. 467, and *Security Mills Co.* v. *Commissioner,* 321 U. S. 281, is misplaced; in both those cases this Court reaffirmed the principle that in the absence of a mistake of law the Tax Court's decision is entitled to finality. The court below correctly held (R. 256–257), in accord with that principle, that reversal of the Tax Court's decision was not warranted merely because an opposite inference might have been drawn from the facts.

CONCLUSION

Neither a conflict of decisions nor a question of general importance is presented. The petition should therefore be denied.

Respectfully submitted.

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